

# Report of the auditor-general to the Northern Cape provincial legislature and the council on Magareng Local Municipality

## Report on the financial statements

### Introduction

1. I was engaged to audit the financial statements of the Magareng Local Municipality set out on pages ... to ..., which comprise the statement of financial position at 30 June 2015, the statement of financial performance, statement of changes in net assets, and cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

#### Property plant and equipment

4. I was unable to obtain sufficient appropriate evidence for property plant and property as the municipality did not have adequate systems in place to maintain records of property plant and property. I was unable to confirm property plant and property by alternative means. Additionally, as described in note 33 restatements was made to rectify prior year misstatements, but the restatement could not be substantiated by supporting audit evidence. Consequently, I was unable to determine whether any adjustments property plant and property stated at R 256 553 706 (2014: R 268 851 742) in the financial statements were necessary.

5. The municipality did not recognise all items of property, plant and equipment relating to infrastructure asset work in progress and other assets in accordance with GRAP 17 *Property, plant and equipment*. I was not able to determine the full extent of the understatement of infrastructure asset for work in progress as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus due to these misstatements.
6. The municipality did not recognised newly identified assets in the prior year in accordance with GRAP 17. Assets was take on at current replacement cost instead of deemed cost. I was not able to determine the full extent of this misstatement as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus due to these misstatements.

### **Investment property**

7. The municipality did not recognise all property held to earn rental or for capital appreciation as investment property in accordance with GRAP 16, *Investment property* for the current and prior year. In the absence of appropriate records and information, I was not able to determine the full extent of the misstatement in investment property as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus

### **Revenue from exchange transactions**

8. I was unable to obtain sufficient appropriate evidence for revenue from exchange transactions relating to service charges for water and electricity as the municipality did not have adequate systems in place to maintain records for these service charges. I was unable to confirm service charges for water and electricity by alternative means. Consequently, I was unable to determine whether any adjustments to service charges for water and electricity stated at R16 184 194 (2014: R13 341 099) and R5 579 211 (2014: R3 578 011) respectively, in the financial statements were necessary.
9. The municipality did not recognise revenue from exchange relating to service charges for water and electricity, in accordance with GRAP 9 *Revenue from exchange transactions* as not all meters were read. I was not able to determine the full extent of the understatement of revenue from exchange relating to water and electricity and receivables from exchange as it was impracticable to do so.

### **Receivables from non-exchange transactions**

10. I was unable to obtain sufficient appropriate evidence for receivables from non-exchange transactions as the municipality did not have adequate systems in place to maintain records of receivables from non-exchange transactions. I was unable to confirm receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments to receivables from non-exchange transactions stated at R2 025 046 (2014: R1 624 114) in the financial statements were necessary.
11. Provision for debt Impairment was not calculated in accordance with GRAP 104 *Financial Instruments*. Receivables from non-exchange transactions were understated and an impairment loss was overstated. I was not able to determine the amount of the adjustment to provision for debt impairment as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus due to these misstatements.

## Receivables from exchange transactions

12. I was unable to obtain sufficient appropriate evidence for receivables from exchange transactions as the municipality did not have adequate systems in place to maintain records of receivables from exchange transactions. I was unable to confirm receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments to receivables from exchange transactions stated at R 2 526 306 (2014: R 12 646 793) in the financial statements were necessary.
13. Provision for debt Impairment was not calculated in accordance with GRAP 104 *Financial Instruments*. Receivables from exchange transactions were understated and an impairment loss was overstated. I was not able to determine the amount of the adjustment to provision for debt impairment as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus due to these misstatements.

## Payables from exchange transactions

14. I was unable to obtain sufficient appropriate evidence for payables from exchange transactions as the municipality did not have adequate systems in place to maintain records of payables from exchange transactions. I was unable to confirm payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments to payables from exchange transactions stated at R 54 442 190 in the financial statements were necessary.

## Expenditure

15. I was unable to obtain sufficient appropriate audit evidence for expenditure transactions relating to contract services and general expenses. The municipality did not have adequate systems in place to maintain records of contract services and general expenses. I was unable to confirm contract service and general expenses by alternative means. Consequently, I was unable to determine whether any adjustments to contract services and general expenses stated at R2 481 737 and R12 377 997, respectively, were necessary.
16. The municipality did not recognise expenditure, in accordance with GRAP 1 *Presentation of financial statements*. Repairs and maintenance were overstated by R1 942 178 and employee relating cost was understated by the same amount, as salaries paid to employees was incorrectly classified under repairs and maintenance. Additionally, there was a resultant impact on the surplus for the period due to these misstatements.
17. The municipality did not recognise expenditure, in accordance with GRAP 1. General expenses were understated as the municipality did not recognise all rebates as well as transactions recorded in the incorrect period. I was not able to determine the amount of the understatement as it was impractical to do. Additionally, there was a resultant impact on the surplus for the period due to these misstatements.

## Irregular expenditure

18. The municipality did not recognise irregular expenditure incurred in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. I was not able to determine the full extent of the misstatement as it was impracticable to do so. The municipality made payments in contravention of the *Supply chain management regulations* which were not included in irregular expenditure. I was not able to determine the amount of the understatement as it was impractical to do.

## **Depreciation and amortisation**

19. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for depreciation. As described in note 33 the restatement was made to rectify a prior year misstatement, but the restatement could not be substantiated by supporting audit evidence. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the depreciation corresponding figure stated at R30 108 065 in the financial statements was necessary.
20. Depreciation was not calculated according to GRAP 17, and as a result depreciation and accumulated depreciation were overstated by R1 785 646. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

## **Taxes**

21. The municipality did not claim all input VAT on qualifying expenses, resulting in the comparative amount of taxes and accumulated surplus being understated by R1 043 355. Additionally, I was unable to obtain sufficient appropriate evidence for taxes as the municipality did not have adequate systems in place to maintain records of taxes. I was unable to confirm the taxes by alternative means. Consequently, I was unable to determine whether any adjustments to taxes stated at R 20 355 350 in the financial statements were necessary.

## **Commitments**

22. The municipality did not disclose all commitments in the financial statements for the current and the previous year in accordance with SA Standards of GRAP 17, which states that the financial statements shall also disclose the amount of contractual commitments for the acquisition of property, plant and equipment. As a register of contracts was not maintained, I was not able to determine the full extent of the understatement of commitments as it was impractical to do so. Additionally, I was unable to obtain sufficient appropriate audit evidence for commitments, due to the status of the accounting records and I was unable to confirm commitments by alternative means. Consequently, I was unable to determine whether any adjustments to commitments disclosed as R 6 037 117 (R15 126 616: 2014) in note 39 to the financial statements were necessary.

## **Distribution losses**

23. Distribution losses for water and electricity was not disclosed, as required by section 125(2d) (i) of the MFMA. I could not determine the amount of this loss as it was impracticable to do so.

## **Aggregation of immaterial uncorrected misstatements**

24. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial performance:
  - Revenue from non-exchange transactions relating to property rate and receivable from non-exchange was understated by R801 655.
  - Employee cost and employee benefit were understated by R615 431

## **Disclaimer of opinion**

25. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## **Emphasis of matters**

26. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Restatement of corresponding figures**

27. As disclosed in note 33 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2015 in the financial statements of the Magareng Local Municipality at, and for the year ended, 30 June 2014.

## **Material losses**

28. As disclosed in note 16 and 17 to the financial statements the municipality made a significant provision for impairment of receivables from exchange transactions and non-exchange transactions to the amount of R 90 948 607 and R 11 137 090 as a result of poor collection practices.

## **Financial sustainability**

29. The financial statements indicates that the municipality incurred a net deficit of R33 762 020 during the year ended 30 June 2015. This along with the other matters as set forth in note 47, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## **Additional matters**

30. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## **Unaudited supplementary schedules**

31. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## Unaudited disclosure notes

32. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon

## Report on other legal and regulatory requirements

33. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

34. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Development priority: Basic service delivery and infrastructure investment on pages x to x
35. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
36. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).
37. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
38. The material findings in respect of the selected development priority are as follows:

## **Basic service delivery and infrastructure development**

### Usefulness of reported performance information

- 39. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 100% of the indicators were not well defined.
- 40. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.
- 41. The reasons for this were failure by management to adhere to the requirements of the FMPPI and a lack of proper systems, processes and technical indicator descriptions.

### Reliability of reported performance information

- 42. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information. The auditee's records not permitting the application of alternative audit procedures.

## **Additional matter**

- 43. I draw attention to the following matter:

## **Unaudited supplementary schedules**

- 44. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## **Achievement of planned targets**

- 45. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraph xx to xx of this report.

## **Compliance with legislation**

- 46. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

47. The adopted integrated development plan (IDP) did not reflect and identify a financial plan as required by sections 26 and 41 of the Municipal Systems Act, as well as Municipal planning and performance management regulation 2(1)(c).
48. The municipality did not give effect to its integrated development plan as required by section 36 of the Municipal Systems Act, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
49. The municipality did not establish a performance management system, as required by section 38(a) of the Municipal Systems Act.
50. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, and improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the Municipal Systems Act and regulation 7 of the Municipal planning and performance management regulations.
51. The annual performance report for the year under review did not include a comparison of the performance with set targets and comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(b) of the Municipal Systems Act.

## **Financial statements, performance and annual reports**

52. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of commitments and payables from exchange identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
53. The 2013/14 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
54. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013/14 annual report was tabled, as required by section 129(1) of the MFMA.
55. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the Municipal Systems Act and the Municipal planning and performance management regulations 12(1) and 12(2)(e).

## **Audit committees**

56. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.



57. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
58. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
59. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
60. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
61. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

## **Internal audit**

62. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
  - it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
  - it did not advise the accounting officer and report to the audit committee on matters relating to accounting procedures and practices and risk and risk management.
63. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

## **Procurement and contract management**

64. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by supply chain management (SCM) regulation 27(3).
65. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
66. Awards were made to providers who are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
67. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
68. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments

requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).

- 69. Awards were made to providers who are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44.
- 70. Sufficient appropriate audit evidence could not be obtained that all contracts and were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive.

## **Human resource management and compensation**

- 71. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of Municipal Systems Act.
- 72. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1) (b) of Municipal Systems Act.
- 73. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
- 74. The competencies of the senior managers were not assessed in a timely manner in order to identify and address gaps in competency levels as required by Municipal Regulations on Minimum Competency Levels 13.
- 75. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Municipal Regulations on Minimum Competency Levels 14(2) (a).
- 76. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Municipal Regulations on Minimum Competency Levels 14(2)(b)/14(3).
- 77. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the Municipal Systems Act.
- 78. Senior managers did not sign performance agreements, as required by section 57(2)(a) of the Municipal Systems Act.

## **Expenditure management**

- 79. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1) of the MFMA.
- 80. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

## **Conditional grants received**

81. Municipal Infrastructure Grant funds were retained without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.

## **Revenue management**

82. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of MFMA.
83. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2) (f) of the MFMA.
84. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated on a monthly basis, as required by section 64(2) (b) of the MFMA.

## **Asset and liability management**

85. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Consequence management**

86. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Internal control**

87. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

88. The accounting officer did not exercise adequate oversight responsibility over financial and performance reporting and compliance with laws and regulations, as the municipality did not address the findings regarding the financial statements, performance information and compliance of the previous year. As a result, there were repeat findings in the current year. This may be also due to the action plan not monitored by the appropriate level of management. Additional to this there is no performance management system in place in the municipality, as a result poor performance is not identified.

## Financial and performance management

89. Weekly and monthly reconciliations were not always adequately prepared for financial items during the year including fixed assets and inventory. This was caused by the municipality not having an asset unit. This has resulted in the consultants having to construct the asset register at year end which has result in numerous errors being identified.
90. The annual performance report contained numerous items that could not be traced to supporting listings and documentation. This was due to staff members within the reporting units not fully understanding the performance information requirements for audit purposes.

## Governance

91. The municipality did not adequately identify risks relating to the information technology environment and the achievement of financial and performance reporting objectives. Consequently, controls were not developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.
92. Internal audit was not effective during the year under review. This negatively affected the audit committee's execution of some of its duties and responsibilities.

Kimberley

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*